TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1952

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SUPREME COURT, U.S.

No. 79

MARTHA L. ALISON

vs.

THE UNITED STATES OF AMERICA

ON CERTIFICATE FROM THE UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

FILED MAY 3, 1952
Order for entire record June 9, 1952

UPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1952

No. 79

MARTHA L. ALISON

vs.

THE UNITED STATES OF AMERICA

CERTIFICATE FROM THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

INDEX

	Original	Print
cord from U.S.D.C. for the Western District of Pennsylvania	1	1
Docket entries	1	1
Stipulation of facts	2	2
Opinion, Marsh, J.	6	5
Conclusions of law	8	6
Judgment	10	8
ceedings in U.S.C.A. for the Third Circuit	11	8
tificate to Supreme Court of the United States	11	8
Statement of facts	11	8
Question presented	14	11
Judges' signatures	14	11
rk's certificate (omitted in printing)	15	
ler to send up entire record	16	11

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[fol. 1]

Appendix

In the United States District Court for the Western District of Pennsylvania

Civil Action No. 3974

Martha L. Alison

v.

United States of America

Docket Entries

Feb. 28, 1945—Complaint filed.

Feb. 28, 1945—Summons issued.

Mar. 7, 1945—Summons returned served with copy and complaint on George Mashank, Ass't U. S. Attorney for Charles F. Uhl, U. S. Attorney, 637 New Federal Bldg., Pgh., Pa. March 1, 1945 at 3:15 PM and on the Attorney General of the United States at Washington, D. C. by sending copy of complaint to him by registered mail March 1, 1945.

Apr. 27, 1950—Answer to Complaint filed.

Dec. 6, 1950—Subpoena returned executed by U. S. Marshal, served on Mrs. Frank W. Dean, 767 Lebanon Ave., Mt. Lebanon, Pa., personally on Dec. 4, 1950 at 5:20 P.M.

Dec. 11, 1950—Order entered assigning case to Judge Marsh for Trial.

Dec. 11, 1950—Stipulation of Facts filed by defendant.

[fol. 2] Dec. 11, 1950—Hearing on Non Jury Trial, before Marsh, J. begun.

Dec. 11, 1950—Hearing concluded C. A. V. Trial Memo filed.

Jan. 16, 1951—Order entered extending time for filing of the Government's brief to February 1, 1951.

May 17, 1951—Findings of Fact; Conclusions of Law; Order of Court entered directing judgment be and the same is hereby entered in favor of the defendant.

May 17, 1951—Pursuant to Order of Court entered Judgment is hereby entered in favor of the defendant. Stephen P. Laffey, Clerk.

May 18, 1951—Notices mailed.

July 12, 1951—Notice of Appeal filed by plaintiff.
July 12, 1951—Copies of Notice of Appeal mailed to Clerk U. S. Court of Appeals and to Counsel with letters.

IN UNITED STATES DISTRICT COURT

STIPULATION OF FACTS

In the above case the following facts are agreed to and submitted to the Court as part of the record.

I

The plaintiff brings this action against the United States pursuant to the provisions of Section 24 of the Judicial Code, as amended, U. S. C. A., Title 28, Section 41 (20), [fol. 3] the action arising under the Internal Revenue Laws of the United States.

II

On or about March 11, 1942, the plaintiff filed her income tax return for the calendar year 1941 wherein she reported a tax of $2,711.78, which was subsequently increased to $2,843.78. The amount of $2.843.78 was paid, $2,711.78 on March 11, 1942, and $132 on November 19, 1942.

III

On March 30, 1943, the plaintiff filed a claim for the refund of the amount of $2,843.78, plus interest, which is based upon a claimed deduction of $21,804.90.

IV

On or about August 28, 1943, the Treasury Department indicated to the plaintiff an intention to reject the claim in full; whereupon, the plaintiff filed with the Internal Revenue Agent in Charge, at Pittsburgh, Pennsylvania, on September 24, 1943, a written protest against the proposed rejection.

V

On May 2, 1944, the Commissioner of Internal Revenue formally notified the plaintiff that her claim for refund

was disallowed for the reason that the loss, which was claimed as a deduction for the year 1941, was an embezzlement attributable to the years 1931 to 1940 and did not occur in 1941.

VI

One J. W. Cree, prior to his death on November 24, 1941, was the manager of several trust estates and also a business agent and adviser for a large number of persons. Among his clients was the plaintiff in this case whose [fol. 4] maiden name was Martha Liggett. When the plaintiff was a minor Mr. Cree was her guardian and after she became of age, Mr. Cree continued as her business agent and adviser. The plaintiff's chief source of income was from real estate and securities and Mr. Cree had complete control and possession of the funds and property of the plaintiff. There was no written agreement between the plaintiff and Mr. Cree respecting funds and securities and no accounting was ever requested or given by Mr. Cree. The account of the plaintiff, as well as other trust accounts, was carried in a separate set of books called the "J. W. Cree, Jr., Trust Account", the funds of which were commingled with his personal funds. The securities were likewise carried in the name of J. W. Cree, Jr.

VII

Shortly after the death of Mr. Cree, the plaintiff found from an examination of his books and records that there was due her cash in the amount of $30,155.37, which sum was not available for the reason that Mr. Cree had commingled those funds with those of his own and had been using them for his personal benefit. The plaintiff was the largest creditor of Mr. Cree's estate and inasmuch as the estate did not have sufficient funds to pay all creditors, an agreement was reached whereby the plaintiff took a loss of $21,804.90 on her claim, which included a cash payment of $3,380.95 to the plaintiff by a creditor of Mr. Cree's estate. This cash payment was made to the plaintiff under date of November 18, 1942. After these transactions were completed, the plaintiff's loss arising out of the settlement amounted to $21,804.90.

[fol. 5]

VIII

Throughout the period from 1931 to the date of Mr. Cree's death on November 24, 1941, Mr. Cree was a director in several banks and prominent in real estate circles as well as in business circles in the City of Pittsburgh. He enjoyed substantial credit and had a reputation of meeting all his obligations as they accrued.

IX

The amounts taken by Mr. Cree and the amounts paid back to the plaintiff, as shown by Mr. Cree's books, are as follows:

Years	Amount Taken	Amount Paid Back	Net Amount Embezzled
1931	$ 8,000.00	$ 2,000.00	$ 6,000.00
1932	500.00	.....	500.00
1934	2,000.00	.....	2,000.00
1935	3,000.00	.....	3,000.00
1936	4,800.00	500.00	4,300.00
1937	2,000.00	.....	2,000.00
1938	4,950.00	1,450.00	3,500.00
1939	4,300.00	.....	4,300.00
1940	1,500.00	.....	1,500.00
1941	.....	.....	.....
	$31,050.00	$ 3,950.00	$27,100.00
Add: "Uninvested principal in principal (stock) Acc't			3,055.37
Total uninvested cash embezzled			$30,155.37

X

The plaintiff had no reason to suspect that any of her funds were being embezzled by Mr. Cree and had no knowledge of such embezzlement until after his death.

[fol. 6]

XI

Either party to this stipulation may offer further evidence not inconsistent with the facts herein stipulated.

Karl E. Weise, Hirsch & Weise, Attorneys for Plaintiff.

Edward C. Boyle, United States Attorney.

IN UNITED STATES DISTRICT COURT

OPINION

MARSH, District Judge:

This case came on for trial before the court without a jury, upon the pleadings and the written stipulation of the facts. Briefs have been filed and considered, and the court makes the following

Findings of Fact

1. The plaintiff brings this action against the United States pursuant to the provisions of Section 24 of the Judicial Code, as amended, U. S. C. A., Title 28, Section 41 (20), now 28 U. S. C. A. 1346 (a) (1), the action arising under the Internal Revenue Laws of the United States.

2. On or about March 11, 1942, the plaintiff filed her income tax return for the calendar year 1941 wherein she reported a tax of $2,711.78, which was subsequently increased to $2,843.78. The amount of $2,843.78 was paid, $2,711.78 on March 11, 1942, and $132.00 on November 19, 1942.

[fol. 7] 3. On March 30, 1943, the plaintiff filed a claim for the refund of the amount of $2,843.78, plus interest, which is based upon a claimed deduction of $21,804.90.

4. On May 2, 1944, the Commissioner of Internal Revenue disallowed the claim.

5. One, J. W. Cree, prior to his death on November 24, 1941, was the manager of several trust estates and also a business agent and adviser for a large number of persons. Among his clients was the plaintiff in this case, whose maiden name was Martha Liggett. When the plaintiff was a minor Mr. Cree was her guardian and after she became of age, Mr. Cree continued as her business agent and adviser. The plaintiff's chief source of income was from real estate and securities and Mr. Cree had complete control and possession of the funds and property of the plaintiff. There was no written agreement between the plaintiff and Mr. Cree respecting the funds and securities and no account was ever requested or given by Mr. Cree. The account of the plaintiff, as well as other trust accounts, was carried in a separate set of books called the "J. W. Cree,

Jr., Trust Account," the funds of which were commingled with his own personal funds. The securities were likewise carried in the name of J. W. Cree, Jr.

6. In 1941, shortly after the death of Mr. Cree, plaintiff discovered that he had embezzled from her the sum of $30,155.37. Certain sums were recovered by the plaintiff which left the net loss to her in the amount of $21,804.90, which she claimed as the deduction from her gross income as set forth in paragraph 3 above.

7. The net loss was established on November 18, 1942.

[fol. 8] 8. "The Net Amount Embezzled" for each year from 1931 to 1940, both inclusive, was determined from Cree's books.

9. No money was taken by Cree during the year 1941.

10. Plaintiff had no reason to suspect that any of her funds were being embezzled by Cree and had no knowledge of such embezzlement until after his death on November 24, 1941.

11. Throughout the period above mentioned, Cree was a director in several banks and prominent in real estate and business circles in the City of Pittsburgh. He enjoyed substantial credit and had a reputation of meeting all his obligations as they accrued.

From the foregoing Findings of Fact the court arrives at the following

Conclusions of Law

1. The plaintiff is not entitled to a deduction of any part of the loss of $21,804.90 in the taxable year 1941.

2. The defendant is entitled to judgment.

Discussion

The applicable provision of the Internal Revenue Code is Section 23 (e) 26 U. S. C. A.,[1] which provides: "In computing net income there shall be allowed as deductions: * * * (e) Losses by individuals. In the case of an in-

[fol. 9] dividual, losses sustained during the taxable year

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[1] Act of May 28, 1938, c. 289, § 23, 52 Stat. 460.

and not compensated for by insurance or otherwise—(1) if incurred in trade or business; or (2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or (3) of property not connected with the trade or business, if the loss arises from fire, storms, shipwreck, or other casualty, or from theft."

In Boston Consol. Gas Co. v. Commissioner of Internal Revenue, 128 F. 2d 473 (C. A. 1, 1942), it was held that a loss sustained by the taxpayer through embezzlement in years prior to 1935 but no- discovered until that year could be deducted as a 1935 loss. The court gave considerable weight to the oppressive and unjust results to the taxpayer who was unable to establish the specific amounts embezzled in any particular year prior to the taxable year. In First Nat. Bank of Sharon, Pa. v. Heiner, 66 F. 2d 925 (C. A. 3, 1933) the Court of Appeals for the Third Circuit held that a loss sustained by the taxpayer through embezzlement prior to 1928 but not discovered until that year could not be deducted as a 1928 loss. The court refused to permit the taxpayer to convert a series of embezzlements in prior years into a bad debt, deductible in the taxable year. Factually these cases resemble the instant case except that here the embezzler was a trustee instead of an employee and the net amount embezzled in each year prior to 1941 was determined from the embezzler's books after his death.

If this were a case of first impression in this Circuit I would follow the conclusion reached in the Boston Consol. Gas Co. case, particularly for the reasons stated in Judge Magruder's concurring opinion.[2] Also, because I perceive [fol. 10] a connotation in the use of the word "sustained" in Section 23 (e) that losses by embezzlement are *sufferd* during the year of bona fide discovery although the property was covertly taken during previous years. It could then be concluded that Mrs. Alison did not sustain a loss until such time as she attempted, without success, to secure a return of her property.[3] However, since I cannot detect

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[2] This concurring opinion was mentioned in a footnote to *Commissioner v. Wilcox*, 327 U. S. 404, 406, which case establishes that embezzled funds do not constitute taxable income to the embezzler.

[3] See *Gwinn Bros. & Co. v. Commissioner*, 7 TC 320.

any fundamental distinction between the instant case and the Sharon case I am bound by the legal principles therein expressed. Judgment will be entered for defendant.

IN UNITED STATES DISTRICT COURT

ORDER

And now, this 17th day of May, 1941, after hearing and upon due and careful consideration, it is ordered that judgment be and the same is hereby entered in favor of the defendant.

(S.) Rabe F. Marsh, United States District Judge.

[fol. 11] IN UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

No. 10,538

[Title omitted]

Certificate to the Supreme Court of the United States

To the Honorable, The Chief Justice and the Associate Justices of the Supreme Court of the United States:

STATEMENT OF FACTS

In the above entitled case an appeal has been taken to this court by the plaintiff; Martha L. Alison, from a judgment of the United States District Court for the Western District of Pennsylvania entered on May 17, 1951 in favor of the defendant, the United States of America, in a civil action instituted under Title 28, United States Code, § 1346(a)(1), to recover the sum of $2,843.78 paid by the plaintiff for income taxes for the calendar year 1941.

From the pleadings and a stipulation of the parties as to the facts the district court made the following findings of fact:

[fol. 12] "1. The plaintiff brings this action against the United States pursuant to the provisions of Section

24 of the Judicial Code, as amended, U. S. C. A., Title 28, Section 41(20), now 28 U. S. C. A. 1346(a)(1), the action arising under the Internal Revenue Laws of the United States.

"2. On or about March 11, 1942, the plaintiff filed her income tax return for the calendar year 1941 wherein she reported a tax of $2,711.78, which was subsequently increased to $2,843.78. The amount of $2,843.78 was paid, $2,711.78 on March 11, 1942, and $132.00 on November 19, 1942.

"3. On March 30, 1943, the plaintiff filed a claim for the refund of the amount of $2,843.78, plus interest, which is based upon a claimed deduction of $21,804.90.

"4. On May 2, 1944, the Commissioner of Internal Revenue disallowed the claim.

"5. One, J. W. Cree, prior to his death on November 24, 1941, was the manager of several trust estates and also a business agent and adviser for a large number of persons. Among his clients was the plaintiff in this case whose maiden name was Martha Liggett. When the plaintiff was a minor Mr. Cree was her guardian and after she became of age, Mr. Cree continued as her business agent and adviser. The plaintiff's chief source of income was from real estate and securities and Mr. Cree had complete control and possession of the funds and property of the plaintiff. There was no written agreement between the plaintiff and Mr. Cree respecting the funds and securities and no accounting was ever requested or given by Mr. Cree. The account of the plaintiff, as well as other trust accounts, was carried in a separate set of books called the 'J. W. Cree, Jr. Trust Account,' the funds of which were commingled with his own personal funds. The securities were likewise carried in the name of J. W. Cree, Jr.

"6. In 1941, shortly after the death of Mr. Cree, plaintiff discovered that he had embezzled from her the sum of $30,155.37. Certain sums were recovered by the plaintiff which left the net loss to her in the amount of $21,804.90, which she claimed as the deduction from her gross income as set forth in paragraph 3 above.

[fol. 13] "7. The net loss was established on November 18, 1942.

"8. 'The Net Amount Embezzled' for each year from 1931 to 1940, both inclusive, was determined from Cree's books.

"9. No money was taken by Cree during the year 1941.

"10. Plaintiff had no reason to suspect that any of her funds were being embezzled by Cree and had no knowledge of such embezzlement until after his death on November 24, 1941.

"11. Throughout the period above mentioned, Cree was a director in several banks and prominent in real estate and business circles in the City of Pittsburgh. He enjoyed substantial credit and had a reputation of meeting all his obligations as they accrued."

The district court filed an opinion, which is reported in 97 F. Supp. 959, and reached the following conclusions of law:

"1. The plaintiff is not entitled to a deduction of any part of the loss of $21,804.90 in the taxable year 1941.

"2. The defendant is entitled to judgment."

Thereupon the district court entered the following judgment:

"And now, this 17th day of May, 1951, after hearing and upon due and careful consideration, it is ordered that judgment be and the same is hereby entered in favor of the defendant.

Rabe F. Marsh, United States District Judge."

The present appeal to this court was then taken by the plaintiff. The appeal was heard by three judges of this [fol. 14] court on February 20, 1952. Thereafter a rehearing before the court in banc was ordered by a majority of the circuit judges and was held on April 21, 1952, before six judges of the court.

The six judges of the court who sat in the rehearing of this case being equally divided in opinion as to whether the plaintiff's loss of $21,804.90 by embezzlement was de-

ductible in computing her taxable net income for the year 1941 in which the loss was discovered, the court hereby certifies the following question of law concerning which it desires instruction for the proper decision of the case, to wit:

QUESTION PRESENTED

When a taxpayer has suffered embezzlements over a period of years prior to 1941 and exact years in which each act of embezzlement took place are subsequently ascertained, are the net losses resulting from such embezzlements deductible by the taxpayer under Section 23 of the Internal Revenue Code in computing her taxable net income for the year 1941, in which year the embezzlements were discovered?

John Biggs, Jr., Chief Judge; Albert B. Maris, Circuit Judge; Herbert F. Goodrich, Circuit Judge; Gerald McLaughlin, Circuit Judge; H. E. Kalodner, Circuit Judge; William H. Hastie, Circuit Judge.

[fol. 15] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 16] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1951

No. 792

MARTHA L. ALISON,

vs.

THE UNITED STATES OF AMERICA

ORDER TO SEND UP ENTIRE RECORD—June 9, 1952

Pursuant to the provisions of section 1254 (3) of Title 28 of the United States Code and par. 2 of Rule 37 of the Rules of this Court it is ordered that the entire record in this case be sent up so that the Court may decide the entire matter in controversy.